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C O N F I D E N T I A L SECTION 01 OF 02 ROME 006149

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E.O. 12958: DECL: 12/26/2012

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SUBJECT: MOD WHITE PAPER: DEFENSE INDUSTRY OVERVIEW

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REF: ROME 5430

CLASSIFIED BY: A/POLITICAL MINISTER-COUNSELOR GARY ROBBINS FOR REASONS
1.5 (B) AND (D)

1. (C) SUMMARY. ITALY'S 2002 DEFENSE WHITE PAPER (WP) PRESENTS THE DEFENSE INDUSTRIAL SECTOR AS A PILLAR OF ITALIAN NATIONAL SECURITY. THE NATIONAL ARMAMENTS DIRECTOR HAS OVERALL RESPONSIBILITY FOR DEFENSE PROCUREMENT AND NEGOTIATING INTERNATIONAL DEFENSE INDUSTRIAL COOPERATION ACCORDS. STATE-CONTROLLED COMPANIES AND A FEW LARGE PRIVATE FIRMS DOMINATE THE DEFENSE SECTOR, ALTHOUGH A HANDFUL OF HIGHLY SPECIALIZED NICHE CONTRACTORS ARE COMPETITIVE. THE GOI SHOULD CONTINUE TO FUND PROGRAMS TO HELP INCREASE EXPORTS AND MARKET COMPETITIVENESS, AND NEEDS TO SPEND MORE ON BASIC R&D, ACCORDING TO THE WP. THE WP CALLS FOR GREATER INTRA-EUROPEAN COORDINATION OF DEFENSE INDUSTRIAL POLICY, BUT AT THE SAME TIME AFFIRMS THAT ITALY WILL CONTINUE TO RELY ON THE U.S. FOR SOME KEY DEFENSE SYSTEMS. DEFENSE MINISTER MARTINO IS COMMITTED TO RATIONALIZING ITALIAN DEFENSE PROCUREMENT AND SPENDING SCARCE FINANCIAL RESOURCES ON BOLSTERING ITALY'S BATTLEFIELD CAPABILITIES. THE COUNTERVAILING NEED TO PROTECT ITALY'S INDUSTRIAL BASE AND JOBS LIMITS HIS ROOM FOR MANEUVER, HOWEVER. END SUMMARY.

2. (U) THIS IS ONE IN A SERIES OF REPORTS ON ITALY'S 2002 WHITE PAPER (WP) ON DEFENSE. THE WP SETS OUT THREE PILLARS OF ITALIAN NATIONAL SECURITY: DEFENSE INDUSTRIAL POLICY, FOREIGN POLICY, AND MILITARY POLICY. UNDER THE MINISTER OF DEFENSE, THE NATIONAL ARMAMENTS DIRECTOR (NAD), CURRENTLY ADMIRAL GIAMPAOLO DI PAOLA, IS RESPONSIBLE FOR DEFENSE
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PROCUREMENT. THE PROCUREMENT BUDGET IS FUNDED THROUGH MULTIPLE APPROPRIATIONS, INCLUDING THOSE FOR THE MINISTRY OF PRODUCTIVE ACTIVITIES (MPA). IN ADDITION TO ACQUISITIONS, WHICH ARE BASED ON PROGRAMS DEFINED BY THE CHOD, DI PAOLA DIRECTS RESEARCH AND DEVELOPMENT AND HAS RESPONSIBILITY FOR SOME 500 PERSONNEL IN THE NATIONAL ARMAMENTS DIRECTORATE. AS THE ITALIAN NAD, DI PAOLA TAKES THE LEAD IN NEGOTIATING BILATERAL AND MULTILATERAL ACCORDS ON DEFENSE INDUSTRIAL COOPERATION.

3. (U) THE MAJOR STATE-CONTROLLED DEFENSE CONTRACTORS ARE FINCANTIERI (SHIPBUILDING) AND FINMECCANICA (AEROSPACE, HELICOPTERS, ELECTRONICS, ENERGY, AND TRANSPORT), WHICH INCLUDES ALENIA DIFESA AND ALENIA AERONAUTICA, AND ALENIA SPAZIO. THE LARGEST PRIVATE FIRMS ARE FIAT AVIO (VEHICLES, PROPULSION SYSTEMS, AND ELECTRONICS); ELETTRONICA (ELECTRONIC WARFARE, AVIONICS); MACCHI (TRAINING AIRCRAFT); BERETTA (SMALL- AND MEDIUM-CALIBER WEAPONS); AND INTERMARINE (NAVAL CONSTRUCTION). THE WP PUTS MARCONI (ELECTRONICS AND COMMUNICATION) IN THIS CAMP, BUT FINMECCANICA IS NOW IN THE PROCESS OF REABSORBING ITS FORMER SUBSIDIARY. TOGETHER, THESE FIRMS ACCOUNT FOR 80 PERCENT OF ITALY'S NATIONAL DEFENSE REQUIREMENTS, PROVIDE APPROXIMATELY 30,000 JOBS, AND EXPORT EQUIPMENT AND MATERIEL WORTH SOME 1.6 BILLION EUROS ANNUALLY, ACCORDING TO THE WP. (COMMENT: A HANDFUL OF SMALL- AND MEDIUM BUSINESSES HAVE DEVELOPED INTO SPECIALIZED PROVIDERS OF ADVANCED TECHNOLOGY DEFENSE EQUIPMENT, SUCH AS THE ROME-BASED SOFTWARE SYSTEMS ENGINEERING FIRM, DATAMAT. THESE FIRMS HAVE TYPICALLY SERVED AS SUBCONTRACTORS TO FINMECCANICA, BUT MORE THAN A DOZEN ARE COMPETING INDEPENDENTLY FOR JSF CONTRACTS UNDER THE "BEST VALUE"
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CONTRACT AWARD SYSTEM. END COMMENT.)

4. (U) THE GOVERNMENT SUPPORTS THE DEFENSE INDUSTRIAL SECTOR THROUGH A JOINT PUBLIC GOVERNMENT-PRIVATE SECTOR COMMITTEE CHAIRED BY THE DEFENSE MINISTER, ACCORDING TO THE WP. WITHIN THE COMMITTEE, OFFICIALS FROM ACROSS THE GOI WORK WITH REPRESENTATIVES FROM ACADEMIA AND THE HIGH-TECH SECTOR (VIA THE ASSOCIATION FOR AEROSPACE DEFENSE INDUSTRIES) TO SET OVERALL DEFENSE INDUSTRIAL POLICY, PROMOTE EXPORTS, AND COORDINATE ASSISTANCE TO ITALIAN FIRMS COMPETING FOR INTERNATIONAL ARMS CONTRACTS. THE MPA, WITH ITS SUBSTANTIAL BUDGET FOR AIDING ITALIAN INDUSTRY, PLAYS A KEY ROLE ON THE COMMITTEE. THE GOI HAS ALSO AIDED THE DEFENSE INDUSTRIAL SECTOR'S ORGANIZATIONAL AND FINANCIAL RESTRUCTURING WITH INTERVENTION TO HELP FINANCE DEVELOPMENT, INCREASE

INTERNATIONAL COMPETITIVENESS AND MARKET ACCESS, AND BETTER FOCUS COMPANIES ON END-USERS. BUILDING A STRONGER MILITARY R&D BASE IS ANOTHER GOI PRIORITY, ACCORDING TO THE PAPER. HOWEVER, IT ACKNOWLEDGES THAT EVEN THOUGH ANNUAL SPENDING HAS INCREASED TO 130 MILLION EUROS, ITALY STILL APPROPRIATES MUCH LESS THAN OTHER MAJOR EUROPEAN COUNTRIES.

15. (U) ACCORDING TO THE WP, ITALY HAS SIGNED 48 BILATERAL DEFENSE INDUSTRIAL COOPERATION AGREEMENTS WITH COUNTRIES AS DIVERSE AS FRANCE, GERMANY, RUSSIA, CHINA, AND SAUDI ARABIA.

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ACTION EUR-00

INFO	LOG-00	NP-00	AID-00	AS-01	ACQ-00	CIAE-00	COME-00
	DOT-00	SRPP-00	DS-00	EAP-00	EB-00	FAAE-00	VC-00
	FRB-00	H-01	TEDE-00	INR-00	IO-00	L-00	VCE-00
	AC-01	NRRC-00	NSAE-00	NSCE-00	OIC-02	OPIC-01	PA-00
	PM-00	PRS-00	ACE-00	P-00	SCT-00	SP-00	IRM-00
	STR-00	TRSE-00	USIE-00	EPAE-00	SSD-00	PMB-00	DSCC-00
	PRM-00	DRL-02	G-00	SSR-00	NFAT-00	SAS-00	/008W

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AMCONSUL NAPLES
SECDEF WASHDC
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TWELVE MORE ARE CURRENTLY BEING NEGOTIATED. THE GOI SUPPORTS
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COORDINATION OF DEFENSE INDUSTRIAL POLICY AT THE EUROPEAN LEVEL -- THROUGH OCCAR, LETTERS OF INTENT, AND THE WEST EUROPEAN ARMAMENTS GROUP -- BUT ACKNOWLEDGES THAT IT IS STILL INCHOATE. THE WP ARGUES THAT JUST AS IT MAKES LITTLE SENSE TO DO NATIONAL DEFENSE PLANNING WITHOUT FOCUSING ON INTER-SERVICE OPERABILITY, THE INCREASING OVERLAP BETWEEN ITALY'S NEEDS AND THOSE OF ITS EUROPEAN PARTNERS MAKES INTRA-EUROPEAN PLANNING ESSENTIAL. HOWEVER, THE GOI WANTS THIS ACCOMPLISHED IN A WAY THAT COMPLEMENTS RATHER THAN COMPETES WITH THE NATO PLANNING PROCESS.

16. (U) COMMERCIALLY, ITALIAN FIRMS ARE LOOKING FOR OPPORTUNITIES TO PARTNER WITH THEIR EUROPEAN COUNTERPARTS ALONG THE LINES OF THE APRIL 2001 AGREEMENT AMONG FINMECCANICA, EADS, AND BAE SYSTEMS TO COOPERATE ON MISSILE DEVELOPMENT, ACCORDING TO THE WP. (COMMENT: FRUSTRATED WITH THEIR INABILITY TO STRIKE EQUITABLE ACCORDS WITH EUROPEAN CONTRACTORS, ITALIAN DEFENSE CONTRACTORS ARE INCREASINGLY LOOKING TO PARTNER WITH U.S. COMPANIES SUCH AS BOEING AND LOCKHEED, WHICH ARE VALUED FOR THE ADVANCED R&D THEY BRING TO BEAR ON PROJECTS, THE HIGH QUALITY OF PRODUCTION, AND THE BENEFITS OF TECHNOLOGY TRANSFER. FOR EXAMPLE, BOEING AND OTOMELARA/FINMECCANICA RECENTLY AGREED TO BEGIN CO-PRODUCTION OF JOINT DIRECT ATTACK MUNITIONS IN MARCH 2003. END COMMENT.) WHILE THE GOI WILL LOOK TO THESE ALLIANCES FOR PROCUREMENT OPPORTUNITIES, THE WP ACKNOWLEDGES THAT ITALY WILL CONTINUE TO RELY ON THE U.S. MARKET AS A KEY SOURCE FOR DEFENSE EQUIPMENT AND TECHNOLOGY BECAUSE OF THE COMPETITIVE ADVANTAGE HELD IN MANY SECTORS BY AMERICAN CONTRACTORS.

17. (C) COMMENT: MINDEF MARTINO IS COMMITTED IN PRINCIPLE
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TO RATIONALIZING ITALIAN DEFENSE PROCUREMENT AND TO SPENDING SCARCE FINANCIAL RESOURCES ON BOLSTERING ITALY'S BATTLEFIELD CAPABILITIES. RECENT ACTIONS (A400M WITHDRAWAL), AGREEMENTS (JSF LEVEL II PARTNERSHIP), AND PURCHASES (BOEING 767 TANKERS) SUGGEST THAT ITALY IS INDEED MOVING IN THE RIGHT DIRECTION. HOWEVER, ITALY IS OVERSTRETCHED IN TERMS OF PROGRAMS THAT ARE ENTERING THE LATTER STAGES OF PRODUCTION, SUCH AS THE EUROFIGHTER COMBAT AIRCRAFT, AND WILL HAVE TO MAKE SOME HARD BUDGETARY CHOICES OVER THE NEXT 2-3 YEARS.

18. (C) COMMENT CONTINUED. PER REFTTEL, MARTINO IS TRYING TO SHIFT EVEN MORE OF THE PROCUREMENT BUDGET TO THE MPA AND

OTHER MINISTRIES. WHILE CURTAILING PARTICIPATION IN SOME EUROPEAN COLLABORATIVE PROGRAMS MIGHT MAKE SENSE FROM A COST-BENEFIT STANDPOINT, THIS RUNS COUNTER TO THE INTERESTS OF ITALY'S STATE-DOMINATED AEROSPACE AND DEFENSE INDUSTRY. MOREOVER, WITH FIAT'S AUTOMOBILE SECTOR IN DIRE STRAITS, THE GOI WILL BE EVEN MORE AVERSE TO RISKING THE EROSION OF ITALY'S INDUSTRIAL BASE AND SACRIFICING JOBS FOR ECONOMIC EFFICIENCY. IT ALSO MAY WELL BE A POLITICAL BRIDGE TOO FAR FOR A GOVERNMENT THAT, DESPITE ITS PRO-U.S. BENT, STILL CLAIMS SOME COMMITMENT TO BUILDING A COMMON EUROPEAN DEFENSE. SEPTTEL WILL FOCUS ON IDENTIFYING MORE PRECISELY THE TRENDS WITHIN THE ITALIAN DEFENSE INDUSTRY, COMMERCIAL AND GOVERNMENTAL ALLIANCE STRATEGY, AND THE NEXUS BETWEEN DOMESTIC POLITICS, BUSINESS IMPERATIVES, AND DEFENSE INDUSTRIAL POLICY. END COMMENT.

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